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BEFORE THE
DEPARTMENT OF TRANSPORTATION
WASHINGTON, D.C.

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U.S.-U.K. Alliance Case
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Docket OST-2001-11029 - 51

REPLY OF US AIRWAYS, INC.

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REPLY OF US AIRWAYS, INC.

US Airways, Inc. ("US Airways"), pursuant to Order 2001-11-10 and Order 2001-12-5, hereby submits this reply in response to the various answers filed in the U.S.-U.K. Alliance proceeding. Implicit in the responses of even the most vigorous opponents of the AA-BA alliance is the recognition that a new, liberalized U.S.-U.K. aviation agreement will soon be reached, providing for the first time competitive access to Heathrow for non-incumbent U.S. carriers. Against this background, the Department of Justice ("DOJ") makes a substantial contribution by confirming unequivocally that in order to ensure a competitive market structure at Heathrow and true open skies in the U.S.-U.K. market, the Department of Transportation ("the Department" or "DOT") must require as a condition of approval for AA-BA the "divestiture of enough slots for new entrants to offer . . . [in addition to nine daily round trips from New York and Boston] substantial new air service from other U.S. cities." (*See* DOJ Press Release, December 17, 2001; *See also* Comments of the Department of Justice ("DOJ Comments"), December 17, 2001, at 5, 49-50, 52-53.)

In light of the inevitability of a new agreement with the U.K., it is now appropriate for the Department to engage in forward thinking and begin the selection of the U.S. gateways and carriers that will be awarded the slots and provided the facilities necessary to serve Heathrow

and create a competitive market structure in the U.S.-Heathrow market. US Airways has clearly demonstrated on the record in this proceeding, without any objection and uncontested by any other participants, that as the carrier with the pre-eminent network in the eastern United States, it is uniquely positioned to provide vigorous competition and unparalleled consumer benefits in the U.S.-Heathrow market from its three gateway hubs at Philadelphia, Pittsburgh, and Charlotte. Four daily roundtrips to Heathrow from US Airways' three gateway cities will provide unsurpassed competition and maximize the public benefits of free and open competition in the U.S.-Heathrow market.

Summary of Principal Points

- It now appears that the U.S. Government will finally succeed in negotiating a new, liberalized air services agreement with the United Kingdom. As the period for submitting comments in this proceeding comes to a close, there is every indication that the U.S. and U.K. are moving swiftly toward replacing the highly restrictive and imbalanced Bermuda II agreement with an "open skies" regime.
- Based on the respective filings of the various participants in this proceeding, it is clear that even the most vigorous opponents of AA-BA and UA-BD -- those who have stopped short of nothing to defeat approval of the proposed alliances -- recognize the inevitability of the U.S. Government reaching a new liberalized bilateral agreement with the U.K.
- The Department of Justice has outlined the circumstances under which it believes antitrust immunity for the AA-BA alliance, which it considers to be highly anticompetitive, could be granted. Importantly, DOJ has stated that to ensure competitive access at Heathrow for new entrants and to achieve *de facto* open skies, the Department must require the divestiture of slots and related facilities to allow U.S. carriers to serve Heathrow from U.S. cities other than just New York and Boston. DOJ's position is fully consistent with that of US Airways: before immunity is granted to the AA-BA alliance, a competitive market structure, including commercially viable access to Heathrow, must be in place from day one of the alliance and necessarily entails Heathrow service from other U.S. gateways like Philadelphia, Charlotte, and Pittsburgh.
- Under these circumstances, the Department is now faced with awarding the slots and ensuring the availability of facilities required for new entrant U.S. carriers, such as US Airways, to serve Heathrow. Specifically, the Department should ascertain, on the record in this proceeding, over which U.S. gateways and by which U.S. carriers

new Heathrow service will be provided. The Department must further ensure that the required commercially viable slots, as well as all related facilities such as gates, club rooms, and ticket counters, are in place at Heathrow so that this service can commence as quickly as possible and before any immunity becomes effective.

- In anticipation of the new Heathrow services for U.S. carriers that will result from a liberalized agreement with the U.K., US Airways has clearly demonstrated to the Department that it is well positioned to provide effective competition in the U.S.-Heathrow market from its three network gateway hubs at Philadelphia, Pittsburgh, and Charlotte. Because it operates an extensive network in the eastern United States, where a majority of U.S.-U.K. passengers originate or terminate their journeys, US Airways will be a strong, growing competitive force in the Heathrow market. But the consumer benefits of US Airways' presence in this market can only be fully realized if US Airways can serve Heathrow from each of its three gateway hubs. Split operations between Heathrow and Gatwick are not a viable commercial option for US Airways.
- To effectuate meaningful competition at Heathrow, the divested slots must be provided to U.S. carriers free of charge and at competitive times. Whatever the merits of a market-based allocation system may be as a theoretical matter, they do not apply in this case where the two largest British and the two largest U.S. carriers at Heathrow are seeking immunity from the antitrust laws to fix prices, coordinate schedules, and pool profits. It would defy logic to impose a substantial financial penalty on new entrants such as US Airways by requiring them to bid and pay for Heathrow access in this context.
- Finally, inasmuch as both alliances now before the Department have vast slot holdings at Heathrow, the Department must require divestitures not only from AA-BA, but from UA-BD as well. In granting antitrust immunity to AA-BA and UA-BD, the Department would be sponsoring the creation of a duopoly at slot and facility-constrained Heathrow with each alliance having the ability to coordinate prices and schedules. It would be inexplicable to require only half of the duopoly to divest the slots and facilities necessary to create a competitive market structure under open skies. Rather, UA-BD's large slot holdings must be part of the competitive solution that provides new entrant access to Heathrow.

I. AS A NEW, LIBERALIZED AVIATION AGREEMENT WITH THE U.K. APPEARS INEVITABLE, THE DEPARTMENT SHOULD NOW BE PREPARED TO AWARD THE SLOTS AND ENSURE THE PROVISION OF THE FACILITIES FOR EXPANDED HEATHROW SERVICES THAT WILL ACCOMPANY THAT AGREEMENT.

It is a virtual certainty that a new, liberalized air services agreement will soon be reached between the U.S. and U.K. Against this background, the Department of Justice's analysis of the

proposed alliances is both instructive and significant. Consistent with its analysis of the 1996 proposed AA-BA alliance, DOJ confirms that approval of the present transaction “threatens a substantial loss of competition and higher prices for a large number of consumers.” (*See* DOJ Comments at 3.) DOJ thus concludes that “without conditions to mitigate the harm, we would oppose the AA/BA transaction as we did three years ago.” (*Id.*)

In terms of the conditions it would impose on the AA-BA transaction in order to ensure competitive access to Heathrow and to effectuate true open skies in the U.S.-U.K. market, DOJ affirms that it would require “additional slots and related facilities over and above the divestitures needed to cure the competitive harm created by the AA/BA transaction.” (*Id.* at 5.) As DOJ more fully explains:

Because of the physical constraints at LHR, even completely neutralizing the competitive harm from combining AA and BA would do little more than preserve and perhaps solidify the concentrated market structure that evolved under the Bermuda II agreement. Therefore, DOJ endorses the goal DOT clearly stated in its last proceeding, where it noted that the public interest required *de facto* Open Skies with the United Kingdom before it would consider antitrust immunity. . . . To achieve *de facto* Open Skies, DOT must provide for slots and related facilities in addition to those needed to remedy competitive harm in the NYC and BOS markets.

(*Id.* at 52-53.)

DOJ’s position that a competitive market structure and meaningful new entry at Heathrow requires the divestiture of a large number of slots to new entrant U.S. carriers before antitrust immunity for the AA-BA alliance becomes effective is consistent with the position taken by US Airways.

Granting such immunity to the two largest U.S. carriers for their respective alliances at Heathrow, without first achieving competitive access at the airport for other U.S. carriers like US Airways, would effectively cut-off any prospect for meaningful price competition in the largest intercontinental aviation market in the

world. Accordingly, . . . [i]f and when the U.S. Government reaches a new, liberalized bilateral agreement with the British, and before it grants antitrust immunity to the AA-BA and/or UA-BD alliances, it is incumbent upon the U.S. Government to ensure that US Airways has competitive access from each of its domestic network gateways to Heathrow.

(See Answer of US Airways, December 14, 2001, at 2.)

With a new U.S.-U.K. bilateral imminent, the opponents of AA-BA will undoubtedly abandon their “scorched earth” tactics to defeat approval of the alliance and urge the Department to move quickly to assign slots so that the valuable rights obtained in the new open skies agreement can be realized. There is already a voluminous record in this Docket and every carrier has been afforded the opportunity to demonstrate the public and competitive benefits of its proposed Heathrow services. Thus, using well-established decisional criteria, the Department should move expeditiously in selecting the gateways and carriers, allocating the requisite slots, and ensuring the availability of facilities so that new U.S.-Heathrow services can commence as quickly as possible and before the alliances become effective.

II. US AIRWAYS IS UNIQUELY POSITIONED TO PROVIDE EFFECTIVE COMPETITION IN THE U.S.-HEATHROW MARKET FROM ITS THREE NETWORK GATEWAY HUBS AT PHILADELPHIA, PITTSBURGH, AND CHARLOTTE.

In anticipation of the availability of new U.S.-Heathrow services, US Airways has clearly demonstrated on this record the competitive impact and enormous public benefits that would result if it were able to provide nonstop Heathrow service from its three gateway hubs at Philadelphia, Pittsburgh, and Charlotte with a total of four daily flights. US Airways has the most extensive domestic system in the eastern United States of any U.S. carrier, particularly in the Northeast and Mid-Atlantic regions where a significant number of U.S.-U.K. passengers originate or terminate their journeys. Accordingly, US Airways is uniquely positioned to be a strong and growing competitive force in the U.S.-Heathrow market, maximizing the benefits for

U.S. consumers of increased Heathrow access. The comprehensive and interconnected service provided by US Airways' three-gateway eastern network will help ensure a competitive market presence that is in the public interest and unsurpassed by any other U.S. carrier.

For American and British consumers to enjoy the substantial benefits offered by US Airways' eastern network, however, US Airways must be able to serve Heathrow from each of its three principal network hubs—each of which plays a critical, complementary role in the airline's network. For a new entrant carrier like US Airways with limited London services, split operations between Heathrow and Gatwick are simply not a commercially viable option.

The Department surely recognizes that granting antitrust immunity to the two largest global networks for U.S.-Heathrow service is an enormous price to pay for the achievement of open skies. However, it is a price worth paying if true *de facto* open skies is achieved. This means fair and competitive access to Heathrow not only for the powerful global networks or bilateral alliances, but for independent air carriers and new entrants, such as US Airways, that can exert price discipline, compete from new alternative gateways, and offer hundreds of communities and millions of consumers new competitive online options. The purpose of open skies is not simply to provide access for the competing global alliances to Europe's premier airport. True open skies means that new entrants, independent carriers, and new cities, which have demonstrated the capacity to provide and support effective, competitive transatlantic service, must also have access to Heathrow.

III. TO ENSURE A COMPETITIVE MARKET STRUCTURE, HEATHROW SLOTS MUST BE ALLOCATED TO U.S. CARRIERS FREE OF CHARGE AND AT COMPETITIVE TIMES.

It has been suggested that the Department may want to employ a market mechanism, such as an auction, to allocate divested Heathrow slots to U.S. carriers. There are serious flaws in this approach under the circumstances of this case.

Combining the two largest British and two largest U.S. carriers at Heathrow into two immunized alliances would create enormous market power. To remedy the anti-competitive effects and to foster a competitive market structure, slots must be divested and made available to new entrant competitors. It defies logic then to assess a substantial financial penalty on the new entrants by forcing them to bid and pay for the use of the slots. In seeking to compete with the substantially strengthened incumbents, which have received and continue to receive their slots without cost, the new entrants would have to pass through the substantial investment costs of their slot acquisitions. The huge sum of money involved would create a financial entry barrier replacing the obstacle that the U.S. Government seeks to eliminate.

Furthermore, who would reap the windfall of a slot auction? The British carriers did not pay for the slots. Why then should they be paid for divesting the slots in order to obtain governmental approval for their immunized alliances? Neither the U.K. Government nor the slot coordinating committee is deserving of a windfall benefit. Indeed, the auction or sale of the slots would violate EU regulations and would be inconsistent with longstanding U.S. policy to provide access to foreign carriers to slot restricted U.S. airports free of charge.

Auctioning off Heathrow slots to the highest bidder will neither remedy the competitive harm caused by the dual grant of antitrust immunity nor provide the greatest competitive benefits

under open skies. To create and sustain a competitive market structure, the divested slots must be provided to U.S. carriers free of charge and at competitive times so they can compete vigorously with the immunized incumbents. This is the only approach that is consistent with EC and U.S. law and policy and that will maximize the benefits of price competition in this market.

IV. TO SECURE AN IMMUNIZED ALLIANCE AT HEATHROW WITH UNITED AIRLINES, BRITISH MIDLAND MUST BE REQUIRED TO SURRENDER HEATHROW SLOTS.

According to DOJ, “[a]pproval of the UA/bmi alliance presents no appreciable harm relative to the status quo because bmi is currently not an actual or potential competitor in U.S.-London markets.” (See DOJ Comments at 3.) US Airways takes issue with DOJ’s cursory treatment of the UA-BD alliance. In essence, DOJ would, without a *quid pro quo*, approve a price fixing cartel because one of the partners does not now, and potentially would not, serve the U.S.-London market. As a factual and legal matter, this conclusion is suspect; as a public policy decision, it would be a travesty.

The U.S. Government’s objective must be to maximize the public benefits achieved from the grant of antitrust immunity to the two largest U.S. and U.K. carriers at Heathrow. British Midland is a large holder of slots at Heathrow. It seeks widespread access to U.S. markets and is requesting the right to fix prices, coordinate schedules, and pool revenues with the second largest carrier in the world. Failure to require British Midland in this context to surrender, free of charge, a number of Heathrow slots in exchange for its immunized alliance would eliminate potential competition.

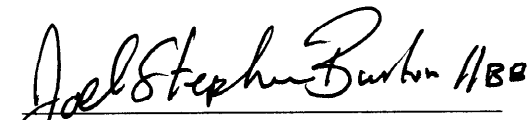
DOJ’s analysis is based on merger guidelines and market analysis that assumes British Midland is not, and will not be, a U.S.-London competitor. Yet DOJ recognizes that DOT has a

broader public interest mandate in determining whether to approve the alliance and grant antitrust immunity. Requiring British Midland to surrender slots in exchange for antitrust immunity would substantially enhance U.S. carrier competition at Heathrow and benefit U.S. consumers. Accordingly, failure to require British Midland to divest slots would be inconsistent with the public interest.

Conclusion

As a new, liberalized aviation agreement with the U.K. appears inevitable, the Department is now faced with the prospect of having to allocate slots and ensure the provision of facilities for new entrant U.S. carriers to serve Heathrow. To this end, US Airways has clearly demonstrated that it is uniquely positioned to provide effective competition in the U.S.-Heathrow market from its three network gateway hubs at Philadelphia, Pittsburgh, and Charlotte. With four daily roundtrips to Heathrow from its three gateway hubs, US Airways will provide unsurpassed competition and maximize the public benefits of free and open competition in the U.S.-Heathrow market.

Respectfully submitted,


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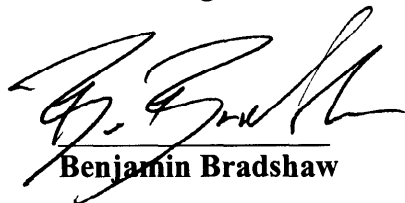
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